RD AN No. 3574 (1965-B)
September 26, 2000

TO: State Directors and Rural Development Managers
Rural Development

ATTN: Multi-Family Housing Program Directors/Coordinators

FROM: James C. Kearney **(Signed by James C. Kearney)**
Administrator
Rural Housing Service

SUBJECT: Analysis of Troubled MFH Properties

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance in evaluating troubled Multi-Family Housing (MFH) properties to determine the appropriate servicing action and provide a methodology for documenting the decision.

COMPARISON WITH PREVIOUS ANs:

This AN replaces AN 3365 (1965-B) dated October 20, 1997.

IMPLEMENTATION RESPONSIBILITIES:

It is always the objective of the Agency to encourage the present borrower to properly carry out the responsibilities of their loan obligation documents. When this cannot be accomplished, Agency intervention may be necessary. This intervention may be in the form of meetings, workout agreements, accelerations, suspensions, or debarments. The State Director will evaluate each project on a case-by-case basis to determine the servicing action that is in the best interest of the Government, the tenants and the community.

To achieve appropriate results, all servicing is to be conducted on a case-by-case basis. Not all properties continue to be viable in meeting the objectives of the Rural Housing Service (RHS) MFH program. The following criteria should be used to evaluate and document servicing decisions before they are implemented (see exhibits A and B):

EXPIRATION DATE: October 31, 2001

FILING INSTRUCTIONS:
Preceding RD
Instruction 1965-B

1. Ownership
2. Need
3. Site/Location
4. Building

The analyst must first consider the ***ownership***. This criterion should be reviewed from two viewpoints:

1. Is the present ownership entity still legally operating? Is the ownership entity cooperative and financially solvent?

2. Also, as a part of the ownership element, we must examine the project management. Is competent management being provided?

If the complex is to be successful, the Agency must insist on changes if the answer to either or both of these questions is no.

The second major cornerstone is the ***need***. The Agency must carefully decide if there is currently a need for the complex as is, or if one can be created by modifications to the complex.

The following items must be carefully evaluated in each community.

1. Is there other affordable, decent, safe and sanitary housing available in the market area to meet the needs of the tenants?

2. Is the housing still needed to meet program objectives?
   a) Has the market changed due to changing demographics or local economic conditions?
   b) Is there a need for a different bedroom mix than the subject property has?
   c) In the case of an on-farm Labor Housing loan, is the operator still farming?
   d) Have there been significant vacancies, which were not reduced with aggressive marketing tactics?

The third major cornerstone that must be considered is the ***site***. Is the site well located in a residential area? Environmentally, is the site acceptable? Are there enhancements necessary to bring the site into compliance?

The site is major consideration in the viability of any complex. The following items should be considered in the full evaluation of the site:

1. Has economic obsolescence adversely affected the community?
2. Does the community have adequate medical, transportation, and school system?
3. Is the site itself located in a solid residential neighborhood that is a viable part of the community?
4. Does the site have frontage along at least one-fourth of the perimeter?
5. Does the topography of the site lend itself to optimal accessibility?
6. Does the site have environmental hazards or commercial influences that adversely affect it?

The fourth major element is ***building***. Is the building structurally sound?

1. Are there other obsolescence factors which are economically unfeasible to correct?

    a) Design obsolescence
    b) Poor construction quality and site problems
    c) Environmental hazards
    d) Structural deterioration creating a health or safety hazard

2. A unit-by-unit inspection report with a cost estimate for necessary rehabilitation or deferred maintenance, wheelchair accessibility and obsolescence factors must be completed by RHS and submitted as part of the problem case report. The Marshall & Swift ACCUPRO program is to be used for verifying the cost estimates for needed repairs. The report shall address all project needs to make the project suitable for the program. Cost estimates are to be sufficient to place the property in operation in as new condition if possible.

3. Can the property be rehabilitated to meet current applicable building codes or can an exception to code requirements be obtained from local authorities?

Upon completion of the analysis of the four major items, the following items must be addressed as well:

1. What is the estimated economic useful life of the property after rehabilitation is completed? Will the amortization of the debt, based upon the economic useful life, make rents unaffordable to program eligible tenants? Will the 1 percent rents exceed the conventional market rents? If so, are financial resources available to make the project financially feasible?

2. Compare the total of the existing debt, any prior or junior liens, and estimated rehabilitation costs on a per unit or per square foot basis to the average new construction cost per unit. Total property debt of existing structures, including rehabilitation costs, is not to exceed current replacement (new) construction costs for the proposed repairs to be considered cost-effective rehabilitation. Much of the existing property is utilized in the rehabilitation process, such as land, site improvements, plans, property survey, excavation, concrete, rough carpentry, plumbing and electrical. Consequently, if rehabilitation costs are at or near 60 percent of cost new, extra consideration and options are to be considered and documented prior to proceeding with rehabilitation.

3. Prepare a cash flow analysis, including any additional debt service for rehabilitation and reamortization of existing debt, if appropriate, to compare basic rents based upon the estimated economic useful life after rehabilitation to rents for available (1) new construction, (2) similar existing projects in the servicing jurisdiction, and (3) conventional rents in the community. Determine any estimated increase in cost per unit of rental assistance and compare to the State average.

4. Can tenants rent other comparable suitable and available housing in the community for the equivalent of or less than the basic (one percent) rent after rehabilitation is completed?

When conducting the preceding analysis, it is important to remember that each property is unique. An analysis focusing only on a rent comparison may not take into consideration the unique housing needs of the community or suggest a need to proceed with rehabilitation. Conversely, where it may be possible to meet a documented need more economically through replacement rather then rehabilitation, a decision will be needed to decide the best use of resources.

For properties which are determined to be no longer viable, the State Director must determine whether there is any recovery value to the Government if the property is liquidated through foreclosure action. If there is no recovery value after all costs of liquidation and resale are considered, (net recovery value) the loan may be debt-settled in accordance with RD Instruction 1956-B.

Determination of net recovery value should be based upon the following criteria:

The value of the property, if sold as a conventional unsubsidized property on a non-program basis, should be compared to the total of the (1) liquidation cost, (2) acquisition cost, (3) settlement cost of prior liens, (4) estimated cost to operate during inventory period, (5) cost to correct health and safety violations or environmental problems, and (6) sales cost. An appraisal is to be completed and used as the basis for this comparison and is the key factor for documenting and supporting servicing decisions.

The cost to operate the project during the inventory holding period prior to resale should be based upon typical operating costs, excluding debt payments to the Government, for similar projects in the servicing jurisdiction. The estimated inventory holding period should be based upon previous experience in selling non-program property in the State and the availability of current funding for non-program inventory properties. If your State has not had experience in marketing non-program properties, please contact the MFHPM division in the National Office.

Based upon a careful analysis of the preceding material, the borrower and servicing official should consider alternatives that include:

1. Transfer to an eligible applicant
2. Sale of the property out of the program
3. Payment in full (after the preservation process of RD Instruction 1965-E has been followed and appropriate restrictive provisions, if any, are signed).

Should ownership be unwilling or unable to complete any of the preferred options, the following should be considered:

1. Foreclosure
2. Voluntary conveyance
3. Debt settlement – compromise, charge-off or cancellation
4. Court action such as suing for specific performance

Properties can be transferred during the foreclosure process. However, the foreclosure process should not be stopped until the transferee is determined eligible and the transfer is determined to be feasible and in the best interest of the Government. When a foreclosure process is initiated, further payments from the borrower will not be accepted. However, depending on state law, the borrower may have the right to cure any monetary default.

The property is to be appraised in "as is" condition and as subsidized to determine the amount of the transfer. To arrive at the "as is" condition, the servicing officials are to document in the unit-by-unit inspection report the number of units suitable for subsidy. "Suitable for subsidy" may be a higher standard than "habitable". The State Appraisal Coordinator should instruct the appraiser through the Task Order which units are determined unsuitable for subsidy and provide the appraiser with a list of requirements for each unit which are necessary to make that unit suitable for subsidy. The requirements for returning units to a condition suitable for subsidy may not be the only deferred maintenance that needs to be addressed in determining the "as is" value.

A second "as improved" appraisal will be completed to determine the maximum debt limit. This appraisal should reflect the value of the property when all units are suitable for subsidy. The appraiser should be given plans and specifications for the proposed rehabilitation to use as key documents in the appraisal.

If the scope of work or type or quality of materials relating to the approved rehabilitation is significantly changed after the appraisal is completed, a revised appraisal may be needed to reflect the differences (if those changes affect the value of the rehabilitated property). The scope of work or materials should not be changed after the appraisal has been completed if the purpose is to reduce any necessary additional borrower contribution, particularly if it impacts the value of the collateral property.

If rehabilitation costs exceed the appraised value and the borrower must contribute funds in excess of the required equity contribution in order to make the project feasible, the borrower may not receive a return to owner on this contribution. If the borrower voluntarily contributes additional funds to reduce the amount of any necessary subsequent loan by the Agency, and the total cost is equal to or under the appraised value, the borrower may receive a return to owner on this increased contribution, as long as it meets the conditions outlined in RD Instruction 1944-E, section 1944.215 (n).

If you have any questions concerning these issues, please call the MFHPM Division at (202) 720-1600.

Attachments **(Exhibit B not available on Internet)**

Exhibit A

515 Analysis Summary

OWNERSHIP

Financially solvent → Yes ____ No ____

Describe deficiencies:

Cooperative → Yes ____ No ____

Describe deficiencies:

Legal entity → Yes ____ No ____

Describe deficiencies:

NEED

Market Study → Yes ____ No ____

Market Analysis → Yes ____ No ____

Describe market conclusion reached:

SITE

Residential in character → Yes ____ No ____

Environmentally sound → Yes ____ No ____

Describe deficiencies:

BUILDING

Structurally sound → Yes ____ No ____

If the answer is No – or questionable – detail your concerns: